Trade war risks just got a whole lot bigger

The US announcement that it is considering tariffs on car imports is a pretty big escalation in the trade war narrative

USD: Protectionist risk premium may return as Trump moves to auto tariffs

Just as many of us were still digesting a fairly intriguing set of FOMC minutes, reports that the US administration is looking into the possible imposition of tariffs on car imports hit the newswires. This was soon confirmed by President Trump in a statement that instructed the Commerce Department to open up a Section 232 investigation into the imports of automobiles to 'determine their effects on America's national security'. Recall that this was the same process that the US administration took before imposing tariffs on steel and aluminium imports in March this year – and while we may still be some way away from the idea of actual tariffs on US car imports (with initial reports floating a 25% tariff), this latest move by the administration is a pretty big escalation in the trade war narrative. Recent history has shown that the impact of US protectionist policies on FX markets has been fairly ambiguous – but we note that speculation tends to be US dollar negative as the currency prices in some notion of a protectionist risk premium. The knee-jerk move lower in USD/JPY lends support to this view – and we now see additional downside risks towards 107-108 in the near-term.

EUR: Euro-phoria looks to be facing a slow death by a thousand data points

'It just ain't happening' is probably the most apt phrase to sum up the prospects of a booming recovery in Eurozone growth this quarter after yesterday's softer PMI readings and dip in consumer confidence. And there's every temptation to extend this sentiment to the euro; in the absence of eurozone economic data finding another gear this side of summer, the chances of a hawkish ECB-led rally in the single currency look pretty bleak. A dovish set of FOMC minutes may help EUR/USD consolidate above 1.17 – though Italian politics may keep any upside in check.

GBP: May transition extension speculation throws another Brexit curveball

Just when the GBP dynamics stemming from a complex UK political landscape couldn't get any murkier, reports that Prime Minister Theresa May is looking to extend the Brexit transition period out to 2023 has thrown another curveball into the mix. It's a bit of a double-edged sword for GBP markets; while the lower economic uncertainty stemming from a prolonged transition period beyond 2021 would be a long-run positive for the pound, we acknowledge that (a) such gains might not be realised until the final Withdrawal Bill has been ratified by the UK and EU later this year and (b) political uncertainty may counterintuitively tick up in the near-term if the idea of another general election (or even a second referendum) gains traction. Stronger retail sales today could lift GBP/USD back above 1.3400.

TRY: CBT delivers 300bp emergency rate hike in a bid to stabilise markets

In response to a 5% decline in the lira, Turkey's central bank responded late yesterday with a 300bp hike in the Late Liquidity Window (LLW) rate to 16.50%. Given that most liquidity is provided through the LLW and our forecast for Turkish CPI to head up to 14% this summer – the move takes Turkey's real policy rate to 250bp. That's still a little light relative to the >3% real rates available in the likes of the rouble, the Brazilian real, Indian rupee and South African rand. But is a large rate hike nonetheless. It also undermines the view of policy paralysis in Ankara ahead of 24 June elections and suggests that policymakers are still looking at conventional tools – putting paid to any suggestions of capital controls. High US rates and crude at $80/bbl are clearly headwinds to much of a TRY recovery. But Ankara will probably settle for some stability.